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L. Seth Stadfeld

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THE FTC FRANCHISE DISCLOSURE RULE AND ITS IMPACT ON CHAPTER 93A OF THE MASSACHUSETTS GENERAL LAWS— A SOURCE OF PROTECTION FOR CONSUMER ENTREPRENEURS

L. SETH STADFELD*

I. INTRODUCTION

On December 21, 1978, the Federal Trade Commission (FTC) promulgated a trade regulation rule¹ and a supporting statement of basis and purpose (hereafter the FTC Rule) in response to vivid evidence of widespread deceptive and unfair conduct in connection with the sale of business opportunities (franchises).² The purpose of this paper is to explore the impact of the FTC Rule on the developing law in Massachusetts under chapter 93A.³

Informed consumers and businesspersons are important to the fair and effective functioning of a free market economy.⁴ The FTC Rule requires disclosure of material information to prospective consumers of business opportunities. It is based on the thesis that such consumers lack the necessary information to make an informed investment decision.⁵ The statement of basis and purpose upon which the FTC Rule is premised contains many important interpretations of section 5(a)(1)⁶ of the Federal Trade Commission

* Associate in the law firm of Brown, Prifti, Leighton and Cohen, Boston, Mass. A.B., Brown University, 1973; J.D. Boston University School of Law, 1976.

1. "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" 16 C.F.R. § 436 (1978) (Trade Regulation Rule and Statement of Basis and Purpose). This rule was promulgated by the FTC pursuant to its rulemaking authority under 15 U.S.C. §§ 41-58 (1976).

2. 43 Fed. Reg. 59,623-27 (1978).

3. Chapter 93A is entitled, "Regulation of Business Practices for Consumers Protection." It provides in pertinent part: "Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful." MASS. GEN. LAWS ANN. ch. 93A, § 2(a) (West 1972). This is the heart of the statute which has remained unchanged since its 1967 enactment. 1967 Mass. Acts ch. 813, § 1.

4. Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 671 n.34 (1977).

5. 43 Fed. Reg. 59,625 (1978).

6. 15 U.S.C. § 45(a)(1)-(6) (1976).

Act (FTCA) as applied in the franchising context. These interpretations stand as instructive and authoritative Massachusetts precedent.⁷ They are wholly incorporated into the body of Massachusetts common and administrative law⁸ now developing under chapter 93A of the Massachusetts General Laws. As will be shown, the FTC Rule's application should not be limited to franchising and should, when appropriate, apply to many other facets of trade and commerce. In addition, it provides a variety of useful and functional suggestions for commercial operators who wish to deal honestly, fairly, and profitably, yet remain free from violation of the statute.

In order to understand fully the meaning of the law embodied in chapter 93A and highlighted by the FTC Rule, this article reviews certain substantive and procedural rules now firmly established under that statute. The article then explores the nature, scope, background and impact of the FTC Rule in Massachusetts.

In this connection, the following will be considered: the substantive provisions of the FTC Rule and their effect on state franchise laws; the impact of the FTC Rule on Massachusetts law under chapter 93A; applicability of the FTC Rule to commercial transactions exclusive of franchising; and suggestions for compliance.

II. CHAPTER 93A

The FTC Rule is important because it stands as persuasive precedent for conduct to which chapter 93A applies. Within the context of business disputes, the FTC Rule represents the most significant injection of precedent into the body of law developing under chapter 93A since its 1967 enactment. Chapter 93A prohibits unfair methods of competition and unfair or deceptive acts or practices in trade or commerce.⁹ Such conduct includes antitrust violations, incipient antitrust violations and lesser types of anticompetitive conduct.¹⁰ In addition, it forbids fraud, deceit, misrepre-

7. MASS. GEN. LAWS ANN. ch. 93A, § 2(b) (West 1972), provides:

It is the intent of the legislature that in construing paragraph (a) of this section the courts will be guided by the interpretations given by the Federal Trade Commission and the Federal Courts to Section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. § 45(a)(1) (1973)), as from time to time amended.

8. *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 694 n.8, 322 N.E.2d 768, 773 n.8 (1975).

9. MASS. GEN. LAWS ANN. ch. 93A, § 2(a) (West 1972). See note 3 *supra*.

10. *FTC v. Texaco Inc.*, 393 U.S. 223 (1968); *FTC v. Brown Shoe Co.*, 384 U.S.

sentation, unfair competition, deception, oppression and unconscionable activities in the commercial context.¹¹ Furthermore, it should apply when a contracting party fails to deal fairly and in good faith.¹²

This vast substantive coverage exists for the benefit of Massachusetts consumers¹³ and businesspersons¹⁴ who may bring private suits for violations of either the statute or the regulations promulgated by the Attorney General.¹⁵ The Attorney General also may seek redress for such violations.¹⁶ The Massachusetts Supreme Judicial Court has recently¹⁷ approved a regulation of general ap-

316 (1966); *FTC v. Cement Inst.*, 333 U.S. 683 (1948). The commercial law practitioner must familiarize himself or herself with the rules governing anticompetitive conduct to understand fully the monumental sweep of ch. 93A.

11. *See* *PMP Assocs., Inc. v. Globe Newspaper Co.*, 366 Mass. 593, 596, 321 N.E.2d 915, 917 (1975) (Tauro, C.J.) (citing *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972)). *See also* note 109 *supra* for a discussion of factors in determining if an act or practice is unfair.

12. *Druker v. Roland Wm. Jutras Assocs.*, 76 Mass. Adv. Sh. 1408, 1411, 348 N.E.2d 763, 765 (1976). [I]n every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.

Id.; *accord*, *Photovest Corp. v. Fotomat Corp.*, [1979] 2 TRADE CAS. (CCH) ¶ 62,869, at 79,019 (7th Cir. 1979); *Fortune v. National Cash Register Co.*, 77 Mass. Adv. Sh. 1569, 364 N.E.2d 125 (1977). For treatment similar to that given in Massachusetts in other states with "little FTC Acts," *see, e.g.*, *Salois v. Mutual of Omaha Ins. Co.*, 90 Wash. 2d 355, 358-59, 581 P.2d 1349, 1351 (1978) where the Washington Supreme Court indicated that a violation of the duty of good faith in commerce may be a *per se* violation of that state's "little FTC Act."

13. MASS. GEN. LAWS ANN. ch. 93A, § 9 (West 1972).

14. *Id.* § 11.

15. *Id.* § 2(c). The Massachusetts Attorney General has promulgated many regulations under ch. 93A and a complete text thereof may be obtained at the State House in Boston. They may also be found in 20 C.M.R. tit. 940, § 3.01-18 (1979). Regulations of a general nature to protect consumer purchasers and tenants have been promulgated. Additionally, regulations specifically covering the nursing home industry, motor vehicle advertising, retail advertising and debt collection practices have been promulgated and are in effect. Most of these regulations are quite broad. The constitutionality of the regulations has not yet been ruled upon by the Supreme Judicial Court.

16. MASS. GEN. LAWS ANN. ch. 93A, §§ 4-8 (West 1972).

17. *Heller v. Silverbranch Constr. Corp.*, 78 Mass. Adv. Sh. 2850, 2856-57, 382 N.E.2d 1065, 1070 (1978), where the following regulation of general applicability respecting ch. 93A violations was upheld.

Without limiting the scope of any other rule, regulation or statute, an act or practice is a violation of Chapter 93A, section 2 if: A) It is oppressive or otherwise unconscionable in any respect; or B) Any person or other legal entity subject to this act fails to disclose to a buyer or prospective buyer any fact,

plicability which rendered unlawful a failure to disclose a material fact to a buyer. Although these regulations promulgated by the Attorney General were designed to apply in the consumer context, they also have been held to apply to transactions between businesspersons.¹⁸ Enforcers of the statute now may rely on the FTC Rule, and particularly on the statement of basis and purpose, as another standard for use in achieving commercial good faith and fair dealing.

There are many remedies available for violation of chapter 93A. Equitable relief is available if suit is brought in the superior or housing court.¹⁹ Damages may be recovered in the superior, district or housing court departments of the trial court.²⁰ Class actions²¹ may be brought under standards which are easier to satisfy than those embodied in either the Massachusetts or Federal Rules of Civil Procedure.²² Moreover, to provide the incentive for private enforcement and to encourage compliance, multiple damages, costs and attorneys' fees may be awarded to a victorious plaintiff.²³ On showing a willful violation, the court must award at least two, but not more than three, times the actual damages.²⁴

the disclosure of which *may* have influenced the buyer or prospective buyer not to enter into the transaction

Attorney General's Rules and Regulations, 20 C.M.R. tit. 940, § 3.16 (1979) (emphasis added).

18. *Public Works Supply Co. v. Stewart & Prince, Inc.*, 77 Mass. App. Ct. Adv. Sh. 870 (1977).

19. MASS. GEN. LAWS ANN. ch. 93A, §§ 9, 11 (West 1972).

20. *Id.* Regarding Housing Court jurisdiction over ch. 93A claims, see 1979 Mass. Acts ch. 72, (overruling *Chakraborti v. Marco S. Marinello Assoc.*, 79 Mass. Adv. Sh. 537, 386 N.E.2d 1248 (1979)). Redress under ch. 93A is also available in small claims court for damages under \$750. Trebling of such loss may be ordered by the court and recoveries pursuant thereto in excess of \$750 may be realized. See MASS. GEN. LAWS ANN. ch. 218, § 21 (West Cum. Supp. 1979).

21. Both FED. R. CIV. P. 23(a) and MASS. R. CIV. P. 23(a) require: (1) that the class be so numerous that joinder of all members is impracticable; (2) that there are questions of law or fact common to the class; (3) that the claims or defenses of the representative parties are typical of those of the class; and (4) that the representative parties will fairly and adequately protect the interests of the class. These requirements must also be satisfied under ch. 93A. See, e.g., *Karedes v. Cities Serv. Oil Co.*, No. 19731 (Mass. Suffolk Super. Ct., Dec. 7, 1979) (Doerfer, J.).

22. MASS. GEN. LAWS ANN. ch. 93A, §§ 9, 11 (West 1972). It is unnecessary to show that class issues "predominate" over individual considerations and that the class suit is "superior" to other methods for adjudication of the controversy. See *Baldassari v. Public Fin. Trust*, 75 Mass. Adv. Sh. 3188, 337 N.E.2d 701 (1975); FED. R. CIV. P. 23(b)(3). See also Bernstein & Berger, *Recent Developments in Private Antitrust Class Actions*, 24 N.Y. L. SCH. L. REV. 819 (1979).

23. MASS. GEN. LAWS ANN. ch. 93A, §§ 9, 11 (West 1972).

24. *Id.* In consumer suits multiple damages must also be awarded to a con-

Chapter 93A is a plaintiff's statute. It embodies new substantive rights which were, practically speaking, unavailable at common law. With the exception of certain rarely occurring transactions which are exempted,²⁵ the vast substantive coverage and potent remedies of chapter 93A are eminently available. It is the effective tool which the courts, the administrative agencies, the Attorney General and the private litigants may use "to discover and make explicit those unexpressed standards of fair dealing which the conscience of the community may progressively develop."²⁶

sumer plaintiff if the defendant's refusal to grant relief upon written demand was made in bad faith or with reason to know that its conduct violated the statute. For an enlightening discussion of factors for consideration in assessing multiple damages and attorneys' fees, see *McGinty v. Beranger Volkswagen, Inc.*, No. 77-752-S (D. Mass., Nov. 7, 1979); *Linthicum v. Archambault*, 79 Mass. Adv. Sh. 2661, 398 N.E.2d 482; *Heller v. Silverbranch Constr. Corp.* (1979), 78 Mass. Adv. Sh. 2850, 382 N.E.2d 1065 (1978); *McLaughlin v. Disarro*, 79 Mass. App. Adv. Sh. 136, 385 N.E.2d 524 (1979). In *McGinty* the plaintiff proved that the defendants misrepresented certified odometer mileage (26,000 instead of 126,000 miles) and under ch. 93A recovered judgment in the amount of \$1,444.75 and attorney's fees of \$1,000. Having found that plaintiffs' counsel worked on the case for 228 hours, the court awarded legal fees equal to less than 20% of that requested. The court also found that plaintiffs' counsel expended extra time because of the defendant's delays in responding to discovery. In support of such award, the court stated: "Even when the statute is remedial and plaintiffs' attorney is in the position of a private attorney general, however, *some reasonable cost-benefit relationship should be observed*. The remedial aspect of these statutes is not directed to the economic hardships of lawyers." *McGinty v. Beranger Volkswagen, Inc.*, No. 77-752-S, at 4 (D. Mass., Nov. 7, 1979) (emphasis added). Query as to whether the liberal provisions for awarding attorney's fees under ch. 93A have been judicially repealed? Cases like *McGinty* give consumer counsel little incentive to take consumer cases. Compare *Linthicum v. Archambault*, 79 Mass. Adv. Sh. 2661, 398 N.E.2d 482 (1979) (breach of contract on rental of home). In addition to declaring factors which should be considered in assessing attorneys' fees under § 11, (e.g. nature of case and issues presented, result obtained, amount involved, time and labor expended, reputation, ability and experience of counsel, and the price usually charged in the area for similar services) the Massachusetts Supreme Judicial Court stated that in order to vindicate the policies of ch. 93A reasonable expert witness fees should normally be recoverable. *Id.* at 26, 398 N.E.2d at 488. See generally Brown, *Calculation of Attorneys' Fees: Franchise and Antitrust Relief*, 2 W. NEW ENG. L. REV. 297 (1979).

25. MASS. GEN. LAWS ANN. ch. 93A, § 3 (West 1972). See *Boston Super Tools Inc. v. R.W. Technologies, Inc.*, 7 MASS. LAW. WEEKLY 652 (D. Mass. 1979) (Caffrey, C.J.). The burden of proving the exemption is on the party claiming it. *Id.*

26. *FTC v. Standard Educ. Soc'y*, 86 F.2d 692, 696 (2d Cir. 1936) (Hand, J.), *rev'd on other grounds*, 302 U.S. 112 (1937). The FTC's order was upheld. *Commonwealth v. DeCotis*, 366 Mass. 234, 316 N.E.2d 748 (1974) (citing 86 F.2d at 692, *rev'd on other grounds*, 302 U.S. at 112).

III. THE FTC RULE

By requiring the disclosure of material facts about the franchisor, the franchised business, and terms of the franchise agreement, the FTC has tried to equalize the informational imbalance which exists between prospective franchisees and franchisors. Material information contained in a disclosure statement of required form and substance, must be disseminated before a sale is consummated.²⁷ There is no federal registration requirement, though such information with substantiation must be made available to the FTC upon request. Although factual disclosure is regulated, the FTC Rule does not prescribe FTC regulation of the franchise relationship. As a result, the FTC Rule cannot be expected to eliminate completely all the injuries caused by abusive conduct on the part of franchisors. It is merely the disclosure aspect of a regulatory scheme designed for the protection of prospective consumer entrepreneurs. It is a seminal step in society's development of business rules for the unsophisticated businessperson.

A. Coverage

Although the FTC Rule is broadly applicable to many consumer and commercial transactions, it is specifically designed to cover continuing commercial franchise relationships²⁸ between sophisticated commercial operators and unsophisticated buyers of small businesses. These relationships typically possess the following characteristics: (1) The franchisee markets goods or services under the franchisor's mark or name which meet the franchisor's quality standards; (2) the franchisor exercises significant control over, or gives the franchisee significant assistance in, the franchisee's operations; and (3) the franchisee pays the franchisor or its affiliate a fee (\$500 plus) within six months after the franchisee opens for busi-

27. It is an unfair or deceptive practice to fail to furnish a prospective offeree with the required information in an accurate and clearly written document at the earlier of the first personal meeting or the "time for making of disclosures." 16 C.F.R. § 436.1(a) (1979). Such "time" is the earlier of ten business days prior to the execution of a franchise agreement (or other similar binding obligation) or the furnishing by said offeree of any consideration in connection with the opportunity offered. *Id.* at 436.2(g).

28. Section 436.2(a) sets forth the definition of a franchise. This would usually include a grant of a right to do business, pursuant to a marketing plan, in connection with a commercial symbol, (trademark, servicemark, logo-type, etc.) of the franchisor/offeree and for which the franchisee pays a fee to the franchisor. *Id.* at § 436.2(a). See CAL. DEP'T OF CORPS., REPORT TO THE SUB-COMMITTEE ON FRANCHISES OF THE ASSEMBLY FINANCE INSURANCE AND COMMERCE COMMITTEE AND SENATE INSURANCE AND FINANCIAL INSTITUTIONS COMMITTEE, 15-17 (1977).

ness. Alternatively, the franchise relationship may possess other characteristics: (1) The franchisee markets goods or services supplied by the franchisor or its affiliate; (2) the franchisor secures retail outlets or accounts, or vending machine or rack display locations for the franchisee or provides the franchisee the services of a person able to do either; and (3) the franchisee pays the franchisor or its affiliate a fee (\$500 plus) within six months after the franchisee opens for business. Whether or not a business relationship fits within the above "franchise" definitions, it is covered by the FTC Rule if it is initially represented as a franchise or similar opportunity.²⁹

B. Information Required To Be Disclosed

Information falling within the following categories must be disclosed in understandable language to the prospective buyer of a business opportunity:³⁰ (1) Identifying information about the franchisor; (2) business experience of the franchisor's directors and key executives; (3) business experience of the franchisor and its parent; (4) litigation history of the franchisor and its directors and key executives; (5) bankruptcy history of the franchisor and its directors and key executives; (6) description of the franchise; (7) money required to be paid by the franchisee to obtain or commence the franchised operation; (8) continuing expenses of the franchisee in operating the franchised business that are payable in whole or in part to the franchisor, directly or indirectly, or to an affiliate; (9) a list of persons, including the franchisor or any of its affiliates with whom the franchisee is required or advised to do business; (10) realty, personalty or services which the franchisee is required to purchase, lease or rent, and a list of any persons with whom such transactions must be made; (11) description of consideration paid, such as royalties or commissions, by third parties to the franchisor or any of its affiliates as a result of a franchisee's purchase from such third parties; (12) description of any franchisor assistance in financing the purchase of a franchise; (13) restrictions placed on a franchisee's conduct of its business; (14) required personal participation by the franchisee, or if the franchisee is not an individual, the participation required by franchisee's principal or principals; (15) description of significant contract rights including termination, cancellation, renewal, transferability and competition

29. 16 C.F.R. § 436.2(a)(5) (1979).

30. *Id.* at § 436.1 (1979).

rights of the franchisee; (16) statistical information about the number of franchisees and their rates of and reasons for termination, failure and reacquisition; (17) franchisor's right to select or approve a site for the franchise; (18) training programs for the franchisee; (19) celebrity involvement with the franchise; and (20) financial information about the franchisor. Moreover, if representations are made about profitability or the earnings potential of an offering, the FTC Rule calls for disclosure of that information through use of a specific form and substance.

The purpose of the FTC Rule is to force disclosure of all information the consumer-entrepreneur would need in making a rational investment decision about a proffered opportunity. Failure to furnish such information in timely fashion and proper form is an unfair or deceptive act or practice within the meaning of section 5 of the FTCA.³¹ Furthermore, the disclosure statement may not contain information other than that required by the FTC Rule or any state law which is not preempted by the FTC Rule.³² The information must be current as of the completion of the franchisor's most recent fiscal year. Revisions must be made on a quarterly basis if there has been any material change relating to the franchising business or the franchisor.

C. *Earnings Claims*

Representations of earnings, actual or potential sales and income or profits of existing or potential franchised operations are forbidden unless:³³ there is a reasonable basis for such representations; the representations are prepared in accordance with generally accepted accounting principles; the franchisor has evidence to substantiate the representations and the evidence is available to a prospective franchisee and the FTC upon reasonable demand; and the representations are geographically relevant. An earnings statement must be furnished on a required form and within the same time constraints as the primary disclosure statement. In addition to accurate representation of financial information and the bases therefor, there must be cautionary language of a specific form advising the prospective franchisee of the importance of the document and of the fact that the representations are merely estimates.³⁴

31. MASS. GEN. LAWS ANN. ch. 93A, § 2(a) (West 1972). See also note 3 *supra*.

32. 16 C.F.R. § 436.1(a)(21) (1979).

33. *Id.* at § 436.1(b), (c) (1979).

34. "CAUTION. These figures are only estimates of what we think you may

Representations of earnings constitute the essence of the opportunity offered since the prospective franchisee bases his or her investment decision on such financial data. By carefully restricting the kind and source of such data and by requiring the availability of substantiation instead of actual substantiation, the FTC has not made compliance unduly burdensome for prospective franchisors or offerors.

D. *Conduct Which Violates the Rule*

The abuses in franchising and franchise sales have been widely recognized. These include antitrust violations, unfair and deceptive acts, breaches of contract and others. Failure to comply with the FTC Rule results not only in violation of the FTCA but as shown later, of the "Little FTC Acts"³⁵ adopted in certain states. In addition to a failure to disclose material information required by the FTC Rule, it is an unfair or deceptive act or practice within the meaning of section 5 of the FTCA for any franchisor or franchise broker: to make representations about the actual or potential sales, income, or profits of existing or prospective franchises except in the manner set forth in the FTC Rule;³⁶ to make any claim or representation, such as in advertising or oral statements by salespersons, which is inconsistent with the information required to be disclosed by the FTC Rule;³⁷ to fail to furnish prospective franchisees,

earn; there is no assurance you'll do as well. If you rely upon our figures you must accept the risk of not doing as well." *Id.* § 436.1(b)(4).

35. "Little or baby FTC Acts" are so named because they are state statutes which, in substance, forbid the same conduct as does Federal Trade Commission Act § 5. 15 U.S.C. § 45 (1976). Unfair methods of competition and unfair or deceptive acts or practices in commerce are prohibited. Although consumer protection statutes have been enacted in practically all fifty states, the "little FTC Acts", such as ch. 93A, are so named because they contain the nearly identical substantive statutory prohibition and because they are to be construed harmoniously with the federal precedent which has developed under the FTCA since its inception. Similar statutes are: ALASKA STAT. §§ 45.50.471-.561 (Supp. 1979); CONN. GEN. STAT. §§ 42-110a to 42-110c (1979); FLA. STAT. ANN. §§ 501.201-.213 (West Cum. Supp. 1979); HAW. REV. STAT. §§ 480-1 to 480-24 (1976); ILL. ANN. STAT. ch. 121½, §§ 261-272 (Smith-Hurd Supp. 1979); LA. REV. STAT. ANN. §§ 1:1401-1:1418 (West Cum. Supp. 1980); ME. REV. STAT. ANN. tit. 5, §§ 206-214 (West 1964); MONT. CODE ANN. §§ 30-14 to 101-142 (1979); N.C. GEN. STAT. §§ 75-1 to 29 (1975); S.C. CODE §§ 39-5 to 10-160 (1976); VT. STAT. ANN. tit. 9, §§ 2451-2462 (1970); WASH. REV. CODE ANN. §§ 19.86.010-.920 (1978); WIS. STAT. ANN. §§ 100.18-.38 (West 1973). For information on state legislation to combat unfair trade practices, contact the Office of Public Information or Counsel for Federal-State Co-Operation, Federal Trade Commission, Washington, D.C. 20580.

36. 16 C.F.R. § 436.1(b)-(e) (1979).

37. *Id.* § 436.1(f).

within the time frames established by the FTC Rule, with copies of the franchisor's standard form franchise agreement and copies of related agreements to be signed by the parties;³⁸ and to fail to return to prospective franchisees any funds or deposits, such as down payments, identified as refundable in the disclosure document.³⁹

In addition, numerous examples of conduct prohibited by the FTC Rule and statute are set forth in the important accompanying statement of basis and purpose. These include misrepresentations of material facts regarding earnings, training, quality and quantity of supply, important contractual restrictions and the like. They also include failure to disclose important information and bad faith breaches of contract. Examples of prohibited conduct will be reviewed below. These represent the current judgment of the FTC as to conduct which appears unfair or deceptive from the businessperson's perspective.

The FTC's interpretation of unfair and deceptive commercial conduct is quite persuasive in Massachusetts.⁴⁰ Furthermore, a review of Massachusetts authorities discloses that only a few cases involving the businessperson's cause of action have been decided by the state's appellate courts.⁴¹ The FTC Rule is, therefore, a spotlight to assist in evaluating unfairness and deception in the commercial arena. The FTC's analyses of various categories of commercial conduct involving the relatively unsophisticated consumer entrepreneur are discussed below in an attempt to isolate basic elements or factors which may be pertinent in other commercial situations. Moreover, although franchising is the particular commercial sector under FTC analysis, these valuable interpretations are applicable to situations involving other business opportunity offerings and perhaps to the many other commercial relations to which chapter 93A is applicable.⁴²

E. *State Franchise Laws—Preemption*

The FTC Rule is intended to function as a minimum disclosure standard in franchising⁴³ and as a supplement to existing state

38. *Id.* § 436.1(g).

39. *Id.* § 436.1(h).

40. MASS. GEN. LAWS ANN. ch. 93A, § 2(b) (West 1972); *see* text accompanying notes 54-64 *infra*.

41. *See, e.g.,* Nader v. Citron, 372 Mass. 96, 360 N.E.2d 870 (1977).

42. MASS. GEN. LAWS ANN. ch. 93A § 1(b) (West 1972). *See* text accompanying notes 133-152 *infra*.

43. 43 Fed. Reg. 59,614, 59,719-22 (1978).

statutes and regulations. States may regulate as they see fit to provide additional protection. The FTC Rule, however, has the force and effect of federal law. It preempts state and local laws to the extent that they conflict.⁴⁴ Examples of state laws which would not be preempted are registration requirements for franchisors and franchise brokers, for escrow and bonding arrangements and for disclosure in excess of that required by the FTC Rule.⁴⁵ Finally, the FTC Rule does not preempt state laws which regulate the conduct of the business (franchise) relationship such as may be involved in termination and renewal practices, other contract terms and financing arrangements.

F. *Current Status of the FTC Rule*

The FTC Rule and statement of basis and purpose were promulgated by the Commission on December 21, 1978. The original effective date of July 21 was postponed three months to October 21, 1979. The extension was needed to complete the guidelines to be used by those attempting to comply with the FTC Rule.⁴⁶ Furthermore, some of the nation's major oil companies and other large franchisors are challenging the FTC Rule as unsupported by the evidence and on due process grounds. The proceedings⁴⁷ are now

44. For a collection of state statutes which regulate franchising see STATE BUSINESS FRANCHISE DISCLOSURE AND RELATIONSHIP LAWS, AS OF JUNE 1, 1978 (CCH) (1978). For a current compilation of such laws, see FRANCHISE LAWS REGS. & RULES (INT'L FRANCHISE ASSOC.).

45. Examples of state franchise statutes which require registration before business may be done in the state are: CAL. CORP. CODE §§ 31110-31111 (West 1977); 1979 Conn. Pub. Acts No. 79-458 (effective date July 1, 1979); R.I. GEN. LAWS § 19-28-5 (Supp. 1978).

46. On July 26, 1979, the FTC adopted final guidelines to assist franchisors in understanding and complying with the FTC Rule. 44 Fed. Reg. 49,966 (1979). The guidelines present the FTC's interpretation of the FTC Rule and factors franchisors should consider in determining (a) which relationships are covered; (b) who is to receive disclosures; (c) when disclosures must be made; and (d) how disclosure documents may be used. *Id.* The guidelines describe and explain the informational requirements for each of the twenty categories of the disclosure statement as well as provide valuable assistance on the use of earnings claims. *Id.* For a critical analysis of the guidelines, see [1979] 7 CURRENT LEGAL DIGEST (published by the International Franchise Association, Washington, D.C.). See also 16 C.F.R. § 436.1 (1979).

47. *In re* FTC Franchise Rule Review, NO. 78-3680 (9th Cir., Consol. May 18, 1979). See also 895 ANTITRUST & TRADE REG. REP. (BNA) A-12 (Jan. 4, 1979); TRADE REG. REP. (CCH) NO. 367, at 3 (Jan. 8, 1979); *id.* NO. 368, at 12 (Jan. 17, 1979); *id.* NO. 407, at 1 (Oct. 19, 1979). The issue before the Ninth Circuit is whether the Rule was promulgated constitutionally and pursuant to proper statutory authority. The FTC asserts that it had the power to promulgate the rule pursuant to the FTCA § 6(g), 15 U.S.C. § 46(g) (1976). In support, it says that in 1975 rulemaking proce-

consolidated before the United States Court of Appeals for the Ninth Circuit. In their application to the United States Supreme Court in which a stay of the FTC Rule's effective date was requested, they contended that such an affirmative rule must be based on facts which exist today in the petroleum industry and not simply on the 1971 to 1974 facts as they existed in the fast food industry. Justice Rehnquist denied the request for a stay on October 16, 1979. Notwithstanding any final decision concerning the effectiveness of the FTC Rule itself, the decision has no effect on the statement of basis and purpose⁴⁸ which is not subject to judicial review.

IV. IMPACT OF THE FTC RULE IN MASSACHUSETTS

A. *The Value of the FTC Rule as Precedent Under Chapter 93A*

The legislature has expressly directed that Massachusetts courts "will" be guided by interpretations given by the FTC and

dures for the FTC were codified by statute in the Magnuson-Moss Warranty—FTC Improvement Act § 202(a), 15 U.S.C. § 57(a) (1976). The FTC further contends, however, that the rule is not a Magnuson-Moss rule in the sense that it need not have followed that Act's statutory rulemaking procedures. According to the FTC, the Rule was issued under the Act's "grandfather" clause which expressly permitted issuance of rules in pre-Magnuson-Moss rulemaking proceedings that had been substantially completed at the time of enactment of the Act. 16 C.F.R. § 202(c)(1) (1979). The public record for the FTC Rule was closed by the FTC on November 20, 1974. A presentation of data, views and arguments was substantially completed prior to the date of enactment of the Magnuson-Moss Warranty Act on January 4, 1975. The FTC Rule was therefore duly promulgated in accordance with the Administrative Procedure Act, 5 U.S.C. § 553 (1976). *See* 43 Fed. Reg. 59,614, 59,637 n.109 (1978).

Those challenging the Rule urged that new rulemaking proceedings should have been held between 1975 and 1979 because of changed circumstances in franchising generally and in certain industries (e.g. oil) in particular. Apparently Justice Rehnquist did not feel that this argument was substantial enough to warrant a stay of the effective date of the Rule. The application was denied on October 16, 1979. *TRADE REG. REP. (CCH) NO. 407*, at 1 (Oct. 19, 1979). For a detailed compilation of the arguments presented to the Ninth Circuit by petitioners and the Commission, *see* [1980] 2 CURRENT LEGAL DIGEST (INT'L FRANCHISE ASSOC.).

Many large oil and automobile corporations which have challenged the rule in the aforementioned proceedings have been informed that they are exempt from its application or that they do not use distribution systems that fall within the FTC's franchise definition. Some are exempt (e.g. auto factories) because they involve bona fide purchases of goods at wholesale by retailers for resale. Others are exempt because they did not require their franchisees to make the required payment of \$500 or more within the first six months of operation. For additional information on exemptions and exclusions, *see* 16 C.F.R. § 436.2(a)(3), (4) (1979).

48. The statement of basis and purpose is not subject to judicial review by a federal appeals court. 15 U.S.C. § 57a(e)(5)(C) (1976). *Katharine Gibbs School, Inc. v. FTC*, 944 ANTITRUST & TRADE REG. REP. (BNA) E-1, 7, 9 (2d Cir. 1979).

the federal courts to section 5(a)(1) of the FTCA.⁴⁹ The Massachusetts Supreme Judicial Court has expressly sustained this approach.⁵⁰ Likewise, the legislature has empowered the Attorney General to promulgate regulations which are not to be inconsistent with the interpretations given by the FTC and federal courts to section 5.⁵¹ Since 1967, many such regulations of general and specific commercial applicability have been promulgated. None of these has been stricken and some have been expressly approved⁵² by the state's appellate courts. Thus, there is ample reason to believe that the FTC interpretations represent persuasive precedent. The Massachusetts Supreme Judicial Court has consulted FTC advisory opinions⁵³ published in the *Federal Register* for guidance in construing and applying chapter 93A. Published opinion letters of FTC staff members may also be considered. Although the statute does not expressly require that FTC interpretations be followed, no express rejection of these interpretations by a Massachusetts court has arisen.

The FTC Rule contains many FTC interpretations of section 5 of the FTCA. These are interpretations of the identical federal statutory prohibition against unfair or deceptive conduct as applied to franchising. In the statement of basis and purpose, many different categories of conduct are evaluated, including misrepresentations, failures to disclose important facts, bad faith contractual breaches and other types of unscrupulous or oppressive business practices. Because generalities cannot sufficiently communicate the unfairness referred to, consider the following examples:

- (1) A New Jersey man invested \$7,500 in a franchise, gave up his job and moved his family to Florida based on representations made by a protection device franchisor that he would receive training assistance and adequate supply of product. He did not and lost his investment.⁵⁴

49. MASS. GEN. LAWS ANN. ch. 93A, § 2(b) (West 1972).

50. PMP Assocs., Inc. v. Globe Newspaper Co., 366 Mass. 593, 321 N.E.2d 915 (1975). "[W]e must look to these interpretations to determine whether the defendant's refusal to accept plaintiff's advertising constitutes an unfair trade practice." *Id.* at 595, 321 N.E.2d at 917; see *Heller v. Silverbranch Constr. Corp.*, 78 Mass. Adv. Sh. 2850, 382 N.E.2d 1065 (1978).

51. MASS. GEN. LAWS ANN. ch. 93A, § 2(c) (West 1972). See note 15 *supra*.

52. See notes 17 & 18 *supra*. See also *Reiter Oldsmobile, Inc. v. General Motors Corp.*, 79 Mass. Adv. Sh. 2091, 393 N.E.2d 376 (1979).

53. PMP Assocs., Inc. v. Globe Newspaper Co., 366 Mass. 593, 598-99, 321 N.E.2d 915, 919 (1975).

54. 43 Fed. Reg. 59,625 (1978).

- (2) Franchisors represented that they had strong connections with famous sports and entertainment personalities when such was not the case.⁵⁵
- (3) A franchisor represented and agreed with prospective franchisees that part or all of their initial investment would be refunded if they decided they did not want the franchised store within the first six months. The franchisor refused to honor the promise.⁵⁶
- (4) A franchisor of parts for all fork-lift trucks persuaded his twenty or more franchisees to purchase \$500,000 worth of special parts for a program to supply one of the largest domestic airlines. The airline deal never materialized; the franchisees were stuck with all the unusable merchandise.⁵⁷
- (5) A convertible sofa bed manufacturer simply informed its distributors that, due to excess shipping expenses, it would no longer make good for defects in workmanship or materials leaving its franchisees to bear the costs thereafter.⁵⁸
- (6) A new gasoline station dealer was required to pay \$5,000 for tires, batteries, and accessories on hand, including a quantity of obsolete fan belts—some for cars not made in twenty years.⁵⁹

The interpretations in the FTC Rule regarding situations like those described above stand as persuasive authority to which Massachusetts courts must look for guidance when confronted with issues arising under chapter 93A. The FTC Rule should be equally persuasive in the other states which have enacted "Little FTC Acts." A uniformity aid, the FTC Rule stands as a virtual treasure chest of FTCA section 5 interpretations of unfairness and deception.

Chapter 93A's elusive "unfairness" and "deception" standards require guidance from the FTC and federal court interpretations. The FTC has expertise in the regulation of trade and commerce; state courts lack such skills and experience. FTC critics claim that, in general, the FTC has fashioned prospective relief rather than penalties or compensation for past conduct which violates the statute. This is a poor justification for discounting the value of such in-

55. *Id.* at 59,630.

56. 43 Fed. Reg. 59,632-33 (1978).

57. H. BROWN, *FRANCHISING: REALTIES AND REMEDIES* 38 (2d ed. 1978).

58. *Id.*

59. *Id.*

interpretations. Since the FTC has continually evaluated unfairness and deception in commerce for years, its interpretations of substantive law in that area have valuable significance. Its views, therefore, merit great weight in the quest for understanding substantive law under chapter 93A. Perhaps less weight should be given by Massachusetts courts to FTC remedial approaches when fashioning relief under chapter 93A. Nevertheless, the differing statutory remedial approaches, albeit significant, have little to do with applications of the practically identical substantive statutory prohibitions.

Therefore, unless clearly erroneous or unless there is a split⁶⁰ among federal circuit courts of appeals as to the soundness of an FTC interpretation, such interpretations are likely to be followed in Massachusetts and in those states which have "Little FTC Acts." Commercial need for nationwide uniformity gives increased support to according FTC interpretations great weight in the area of trade regulation.

The FTC's interpretation as to conduct which is unfair or deceptive need not be only prospectively applied because the interpretations constitute construction of a statute enacted in 1938.⁶¹ In years past, commercial operators were supposed to comply with these statutory prohibitions. Since 1938, the FTC, the federal courts, Congress, state legislatures and state courts have all taken part in advancing the interests of the consumer.⁶² With regard to deception, the decisions encompass a broad spectrum of illegal practices. These deceptive practices include: Failing to disclose kickbacks in connection with the sale of franchises; misrepresenting the nature of services for franchisees;⁶³ and misrepresenting the

60. *FTC v. Texaco Oil Corp.*, 393 U.S. 223 (1968).

61. As originally enacted in 1914, § 5 of the FTCA authorized the FTC to proscribe only unfair methods of competition. Act of September 15, 1914, ch. 311, § 5(a), 38 Stat. 719. The early FTC cases contained rulings to the effect that this language required a showing that a challenged practice injured or tended to injure present or potential competitors, and that consumer exploitation or deception alone was not sufficient to establish a violation. *FTC v. R.F. Keppel & Bro.*, 291 U.S. 304 (1934); *FTC v. Raladam Co.*, 283 U.S. 643 (1931). In 1938, the Wheeler-Lea Amendment added the prohibition against "unfair or deceptive acts or practices" to the text of § 5. Act of March 21, 1938, ch. 49, § 3, 52 Stat. 111. This conferred on the FTC the ability to center its attention on protection of consumers from such acts or practices without regard to potential anticompetitive effects. See generally *ANTI-TRUST LAW DEVELOPMENTS* 165-228 (1975) (published by the ABA).

62. Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661 (1977).

63. *In re Barton's Candy Inc.*, 79 F.T.C. 101, 106 (1971). This case also included deceptive claims of surveys and electronic site analysis.

operational methods to be used by franchisees as well as the expectable potential earnings from a franchise.⁶⁴ In addition, there is an established body of law under section 5 of the FTCA proscribing anticompetitive conduct, such as confinement of sales to specified territories, vertical and horizontal price fixing,⁶⁵ and tying violations.⁶⁶ As a result, commercial operators will be unable to argue convincingly solely for prospective application because of their reliance on established commercial conduct later found to have violated the statute.

This is also true with respect to "unfairness." Admittedly, there is less federal precedent in this category. It was not until 1972 that the United States Supreme Court confirmed that conduct may be unlawful as an unfair act or practice without in any way being deceptive or anticompetitive.⁶⁷ Since then, the Massachusetts Supreme Judicial Court has construed the term "unfair" in a variety of circumstances. For example, in *Commonwealth v. DeCotis*,⁶⁸ it affirmed a judgment that it was unfair for a mobile home park operator to exact by contract a charge from mobile home owners for the transfer of a licensed space in the park when no meaningful service was performed in exchange. Embracing the strong public policy underlying the statute and applying its prohibitions broadly, the court rejected the defendant's argument that such charges were uniformly collected by mobile home park operators in the Commonwealth. The existence of an industry-wide practice did not constitute a defense for unlawful conduct.⁶⁹ Such a reliance interest may possibly prevail if the practice conformed and complied with an established commercial custom in the community as understood at common law.⁷⁰ Nevertheless, the FTC Rule was designed to re-

64. *Chicken Unltd. Inc. v. Bockover*, 873 ANTITRUST & TRADE REG. REP. (BNA) D-1 (Fla. Cir. Ct. 1978), *rev'd on other grounds*, 374 So. 2d 96 (Fla. Dist. Ct. App. 1979) (regarding profitability representations under Florida's "little F.T.C. Act").

65. *Adolph Coors Co. v. FTC*, 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); *In re Chock Full of Nuts Corp. Inc.*, 83 F.T.C. 575 (1973); 43 Fed. Reg. 59,719 (1978).

66. *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966); *In re Howard Johnson Co.*, [1976-1979 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,577, at 21,685 (F.T.C. 1979) (other than 23 unique products, the franchisor was banned from requiring franchisees to buy some 170 products from the franchisor and was ordered to license others to manufacture same under specifications).

67. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

68. 366 Mass. 234, 316 N.E.2d 748 (1974).

69. *Id.* at 240-21, 316 N.E.2d at 748.

70. *Compare Dixon, Irmaos & Cia. v. Chase Nat'l Bank*, 144 F.2d 759 (2d Cir.

quire disclosure of information which should have been volunteered in the past, but was not. Through chapter 93A, the FTC Rule must be rendered effective to combat the pervasive deception which has crippled franchising in the past.

B. *The Effect of the FTC Rule on Unfairness and Deception Analysis*

The FTC Rule is intended to benefit unsophisticated consumer entrepreneurs—those who may be easily exploited because they lack sufficient information to make a well-informed investment decision. Although the federal cases have indicated that section 5 of the FTCA was primarily intended to protect the unthinking, ignorant and naive,⁷¹ these consumer entrepreneurs are also included among those for whom new substantive commercial rights were created under chapter 93A. The purpose here is to examine exemplary categories of commercial conduct discussed in the FTC Rule in order to elucidate factors which may indicate other commercial conduct which is deceptive or unfair. Comparison with Massachusetts decisions and those of other states will be made when appropriate.

In certain commercial transactions, there must be dissemination of material information to protect the commercial operator and to provide the consumer entrepreneur with basic data needed to make a rational investment decision. This simply means that the commercial operator must affirmatively disclose all important facts and act in good faith with due diligence. One way to do this is to view the transaction from the customer's position and to determine what information would be needed to make a proper decision under the circumstances.

1944), *cert. denied*, 324 U.S. 850 (1945) with *T. J. Hooper*, 60 F.2d 737 (2d Cir. 1932). In general, the existence of a custom may be established and incorporated into agreements by implication with regard to subject matter about which known usages prevail. Such usages or customs must be established as accepted common practice by a group in the community, must be relied on by the group for the effective continuance of commercial transactions and must be viewed as obligatory by those within the group. Furthermore, it must be an old or well established practice. In *Dixon*, the court incorporated into the provisions of a letter of credit agreement the uniform custom among New York banks, exporters and importers to the effect that, in lieu of a missing bill or bills of lading presented under credits calling for a full set of bills of lading, the bank issuing the credits would accept a guaranty of a leading New York bank. *Compare In re General Motors Corp.*, 934 ANTITRUST & TRADE REG. REP. A-13-14 (1979).

71. *Aronberg v. FTC*, 132 F.2d 165, 167 (7th Cir. 1942).

1. Misrepresentation in the Franchise Offering

The FTC found that many franchisors made deceptive representations concerning material facts about their franchise offerings. These⁷² include false or misleading statements about: the quality or quantity of supplies, equipment or services to be provided; the timing in which products or services would be provided; the value of advertising to be provided; the value and profitability of the franchise offered; the franchisor's background, financial condition and relationships with affiliates and public figures; and exclusive territorial protection to be afforded franchisees. The complaints raised in public hearings⁷³ before the FTC demonstrated the economic harm caused by franchisees' reliance on franchisors' representations concerning the matters set forth above. To the extent any such representation is false or misleading, it is deceptive under section 5 of the FTCA if the party to whom the representation was made would have justifiably not consummated a business transaction had the truth been known. Such conduct also violates chapter 93A.⁷⁴ It need only be shown that the material representation had the capacity or tendency to deceive.⁷⁵

Profitability representations are most significant to offerees of business opportunities.⁷⁶ False or misleading statements as to value

72. 43 Fed. Reg. 59,628-31 (1978). See 20 C.M.R. tit. 940, § 3.03 (1978) (regarding deceptive advertising of guarantees).

73. 43 Fed. Reg. 59,622, 59,628-31 (1978). These public hearings occurred in 1972.

74. See, e.g., *Stolarcyk v. Doug Russell, Inc.*, No. 1013 (Mass. Super. Ct. 1977). A dealer misrepresented that a boat was "a demo" when in fact it had been owned by a third party and had been damaged. This was held to violate ch. 93A and multiple damages plus attorneys' fees were awarded. *Id.*

75. There is no need to show fraudulent conduct or intent to deceive under FTCA § 5, nor is it necessary to show that the act or practice actually deceived a party. "Innocence of motive" does not relieve a party of his duties to comply. *FTC v. Algoma Lumber Co.*, 291 U.S. 67, 81 (1934) (Cardozo, J.). It is only necessary to show that the practice has the capacity to deceive. *Charles of the Ritz Distribs. Corp. v. FTC*, 143 F.2d 676 (2d Cir. 1944); accord, 20 C.M.R. tit. 940, § 3.05 (1978). "No claim or representation shall be made by any means concerning a product which directly, or by implication, or by failure to disclose additional relevant information has the capacity or tendency or effect of deceiving buyers or prospective buyers in any material respect." *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 704, 322 N.E.2d 768, 778 (1975) (quoting Section IV(A) of the rules and regulations of the Attorney General). See also *McGinty v. Beranger Volkswagon*, No. 77-752-S, at 3 (D. Mass., Nov. 7, 1979).

76. The public record is replete with spurious representations as to profitability in franchising. Consider the following examples of exaggerated earnings projections. A cosmetics franchisor, which itself reported only a \$3,000 profit during the relevant fiscal period, was projecting a typical annual profit of between \$20,000 and \$86,000

or moneymaking capacity are material and, therefore, unfair and deceptive if unsubstantiated or made without a reasonable basis.⁷⁷

False or misleading statements about a party's background, financial condition, current operating status and relationships with affiliates or public figures are "deceptive" as they directly affect the value of a business offering. Clearly, it would be deceptive to represent that an entity is financially stable when the opposite is true. Similarly, a representation of affiliation⁷⁸ with a famous personality could be irrelevant as to the actual merits of a specific offering, perhaps with an inherently misleading implication as to the veracity of the claim. It may be of crucial significance to the offeree that certain individuals actively manage or control the venture for which his investment was solicited. There is no doubt that economic harm can and has resulted from reliance on false or misleading statements regarding executive management and administrative capabilities. There is a duty to disclose material facts concerning management. Therefore, both misrepresentation and failure to disclose such facts are deceptive and unfair.

Of like significance are representations or promises that a party will be granted an exclusive right, such as the right to operate in a defined territory free from intrabrand competition.⁷⁹ Because exclusive territories are desirable to franchisees, they often operate as a selling tool for franchisors. Often, in good faith, the franchisee makes an all-out sales effort to develop the market in his territory. He or she should not be deprived of the good will created because of intrabrand competition by another franchisee or company store if representations or promises were made to the contrary. If in fact there is no exclusive right, the offering is of substantially lesser value without such protection, and an unfair and deceptive act has occurred.

for buyers of its franchises. A fabric repair franchising company projected that franchisees would realize returns ranging from 138 percent to 298 percent on a \$15,500 investment, yet it failed to disclose that it recently suffered a loss in its own similar company operation and that during the last fiscal year three of its franchisees went out of business. 43 Fed. Reg. 59,629-31 (1978). *See generally* H. BROWN, *supra* note 57 at 32-51 & 119-156.

77. 43 Fed. Reg. 59,632 (1978). In addition to "little FTC Acts," some states have enacted statutes regulating franchise or business offerings in particular. *See, e.g.*, FLA STAT. § 817.416 (1976), which forbids the intentional misrepresentation of a business offering's chances for success. *See also* 20 C.M.R. tit. 940, § 3-01(17) (1978) (the word "product" is defined to include "franchise.").

78. Such a misrepresentation violates the statute. 15 U.S.C. § 45 (1976). *See also* 43 Fed. Reg. 59,630, 59,677 (1978).

79. 43 Fed. Reg. 59,630-31 (1978).

By comparison, to prosecute a claim for common law misrepresentation, the victim must show express misstatement, planned reliance and damage resulting directly from the conduct.⁸⁰ In Massachusetts, however, recovery in a deceit action also may be obtained if a false statement was made as of a party's own knowledge. The statement cannot be merely a matter of opinion, estimate, or judgment; it must be susceptible of knowledge. It is then unnecessary to prove actual intent to deceive.⁸¹

The FTC Rule's test for deception is merely whether the representation "has a tendency to deceive the consumer"⁸² in any particular which could reasonably influence the latter's buying choice."⁸³ Similarly, under the regulation promulgated by the Massachusetts Attorney General, the standard is whether the claim or representation has the capacity to, or effect of, deceiving buyers or prospective buyers.⁸⁴ To realize the objective of protecting consumers and less sophisticated businesspersons from exploitation by those with more information and experience, actual deception need not be shown.⁸⁵ The sophisticated marketing specialist must now satisfy the new legal policies of good faith, due diligence, and honesty.

2. Unsubstantiated or Atypical Profitability Claims

The potential buyer of a business is crucially concerned with potential sales, income, profits or take-home pay from the proposed venture. Profit projections are particularly susceptible to inaccuracy even when made in good faith.⁸⁶ The abuse which has been rampant in franchising may not differ significantly from that in other segments of the economy. Offerors have often made glowing earnings projections regarding a particular venture: when they did not know the true past profits of similar ventures already

80. RESTATEMENT OF TORTS § 525.

81. *Powell v. Rasmussen*, 355 Mass. 117, 243 N.E.2d 167 (1969); *Yorke v. Taylor*, 332 Mass. 368, 124 N.E.2d 912 (1954); *Chatham Furnace Co. v. Moffat*, 147 Mass. 403, 18 N.E. 168, 169 (1888).

82. Note that in the context of the FTC Rule, the term "consumer" refers to prospective franchisee or business opportunity offeree. Regarding ch. 93A, such a party would bring suit under § 11 as a businessperson rather than under § 9 as a consumer.

83. 43 Fed. Reg. 59,631 nn. 58 & 59 (1978) (citing *FTC v. Algoma Lumber Co.*, 291 U.S. 67, 81 (1934)) (additional citations omitted).

84. See note 75 *supra*.

85. See notes 75 & 83 *supra*.

86. See text accompanying notes 33-34 *supra*.

sold;⁸⁷ when in fact there were no such similar ventures or were very few of them;⁸⁸ or when the venture used as an example of potential profitability had in fact experienced atypical earnings as compared with a similar venture offered or the majority of other similar ventures offered in the past.⁸⁹

If statements or projections are not typically representative for the particular business and location or not adequately substantiated when disseminated, they would be both "unfair and deceptive" under section 5 of the FTCA⁹⁰ and section 2 of chapter 93A.⁹¹

The FTC Rule requires that profitability computations and representations be made in accordance with generally accepted accounting principles and that they be geographically typical. Though data need not be furnished initially, the bases for the representations or calculations must be made available on demand both to the FTC and to the offeree. Offering data can be based either on thorough market testing or on a proven track record, provided that there is honest and pointed disclosure of the sources. Even so, the offeror must give to the offeree the warning contained in the specific disclaimer language prescribed by the FTC.

The crucial factor lies in the information imbalance existing between buyers and sellers of business opportunities and the ease of buyer exploitation. To further the promotion of informed busi-

87. 43 Fed. Reg. 59,631 n.64 (1978).

88. *Id.* at 59,632 n.65.

89. *Id.* at 59,632 nn.66 & 67. *Chicken Unltd. Inc. v. Bockover*, 873 ANTITRUST & TRADE REG. REP. (BNA) D-1 (Fla. Cir. Ct. 1978), *rev'd on other grounds*, 374 So. 2d 96 (Fla. Dist. Ct. App. 1979) (regarding profitability representations under Florida's "little FTC Act").

90. 43 Fed. Reg. 59,632 (1978).

91. The FTC Rule is to be contrasted with the format used by some states where franchise registration laws require franchisors to register material information with state agencies and to give this information to franchisees in the form of a written prospectus. The composite of these state law requirements has been assembled in the Uniform Franchise Offering Circular (U.F.O.C.), devised by the Midwest Securities Commissioners Association in cooperation with industry representatives. The U.F.O.C., para. 19.c.(4) and (5), forbids the making of profitability representations unless based on audited financial statements of existing franchisees. New franchisors would be confronted with a serious barrier to entry since they could not possess such financial reports. Because of that anticompetitive barrier, all but two states have waived this requirement. In many other respects, the U.F.O.C. is superior to the FTC Rule because it requires more detailed disclosure as well as public filing and approval of the state regulatory agency before a franchisor can begin doing business in the state. *See* H. BROWN, *supra* note 57, at 165, 177-78 & 398-428 for a cogent explanation of state franchise regulation and in particular the differences and similarities between the FTC Rule and various state rules requiring disclosure as outlined in the U.F.O.C.

ness decisionmaking and simply as a matter of marketplace fairness and economic sense, a consumer-entrepreneur is entitled to rely upon an offeror to represent truthfully and have a reasonable basis for making performance claims.⁹² It is neither unduly costly nor burdensome for offerors to shoulder this responsibility as compared with the economic losses which may be incurred by the victims of unsupported claims.

3. Failure to Honor Refund or Payment Representations

Not only in franchising, but throughout commerce, the failure to keep a refund promise is a material misrepresentation regarding investment risk. Failure to make a refund, as and when promised, can cause devastating injury particularly if the deposit is substantial. In real estate transactions, builders, sellers and brokers often contract to refund deposits if substantial performance does not take place within a prescribed period. This may be followed by either failure to perform or failure to refund the deposit with complete or reckless disregard for the consequences. Under the FTC Rule,⁹³ in the franchise context, a failure to refund a deposit as agreed violates section 5 of the FTCA. The same standard should apply fairly to a variety of other offerings of business and real estate opportunities.

Under section 2 of chapter 93A, this interpretation of the FTCA must be used as a guide for enforcement. Although the fa-

92. *In re Pfizer, Inc.*, 81 F.T.C. 23, 62 (1972). 20 C.M.R. tit. 940, § 3:11(2) (1978) states that: "It is an unfair and deceptive trade practice to make any representations as to opportunities . . . or to promote any activity, occupation, or vocation as being profitable for one engaging in it if in fact the representations as to the opportunities available or profits to be made are untrue."

93. The FTC Rule refund policy was forcefully expounded by the FTC in its statement of basis and purpose where it stated:

[A] representation which has a substantial tendency or capacity to deceive persons in their purchasing decisions is unlawful under section 5 of the Federal Trade Commission Act. A representation that a deposit or fee will be refunded, when subsequently not honored, is deceptive because it misrepresents the actual financial risk of the transaction. The practice of failing to honor contractual refund provisions is also unfair under section 5 of the Federal Trade Commission Act (under the criteria for "unfairness" set out by the Commission in the "cigarette rule" proceeding) because it violates the fundamental public policy favoring the fulfillment of contract obligations and it results in substantial injury to promisees. Commission cases have long recognized that the failure to return deposits on the purchase price in a consumer transaction, contrary to representations made, is an unfair and deceptive act or practice in violation of the Federal Trade Commission Act.

43 Fed. Reg. 59,633 (1978). See also 29 Fed. Reg. 8,324, 8,355 (1978) (regarding the "cigarette rule" proceeding).

miliar violations of the statute are tortious in nature, the failure to refund may be viewed as a derivative of contract law.⁹⁴ The "unfairness" can be found in the serious impact on the buyer when a substantial deposit is involved coupled with the representational character of the unequivocal promise to refund promptly in the absence of substantial compliance. The inequity is similar to the breach of the implied covenant of good faith and fair dealing when one party to a contract unjustifiably deprives the other of the fruits of the contract.⁹⁵ A knowing violation of this covenant with reckless disregard for the consequences should be viewed as an unfair or deceptive act or practice under chapter 93A.⁹⁶

4. Failure to Disclose Material Facts

The FTC Rule is of acute assistance in the area of disclosure because it sheds light on the dichotomy between "unfairness" analysis and "deception" analysis. It discusses and applies the unfairness criteria⁹⁷ approved by both the United States Supreme Court

94. See *Photovest Corp. v. Fotomat Corp.*, [1979] 2 TRADE CAS. (CCH) ¶ 62,869, at 79,019 (7th Cir. 1979); *Fortune v. National Cash Register*, 77 Mass. Adv. Sh. 1569, 364 N.E.2d 125 (1977); *Drucker v. Roland Wm. Jutras Assocs.*, 76 Mass. Adv. Sh. 1408, 348 N.E.2d 763 (1976); *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 322 N.E.2d 768 (1975); *Commonwealth v. Decotis*, 366 Mass. 234, 316 N.E.2d 748 (1974); *Salois v. Mutual of Omaha Ins. Co.*, 90 Wash. 2d 335, 581 P.2d 1349 (1978).

95. See note 94 *supra*. See also H. BROWN, *supra* note 57 at 240-72.

96. *Salois v. Mutual of Omaha Ins. Co.*, 90 Wash. 2d 335, 581 P.2d 1349 (1978). The Massachusetts Attorney General has promulgated regulations concerning refund representations. 20 C.M.R. tit. 940, §§ 3.01 to .05 (1979). A refund is covered by regulations concerning deceptive warranties or guarantees. *Id.* § 3.03. The regulations define a warranty as any statement in the nature of an express warranty or guarantee which includes any affirmation of fact or promise made by the seller to the buyer which relates to the product offered and "becomes part of the basis of the bargain." *Id.* § 3.01(24). See general regulations designed to protect consumer purchasers where "warranty/guarantee" is defined. *Id.* § 3.01(24). See also 16 C.F.R. § 436.1(b)-(e) (1979). " 'Satisfaction or your money back' . . . or similar representations will be construed as a guarantee that the full purchase price will be refunded at the option of the buyer." 20 C.M.R. tit. 940, § 3.02(3) (1979). Paragraph II.F. provides that: "A seller . . . shall not . . . represent that a product is guaranteed when he cannot or does not promptly and scrupulously fulfill his obligations under the guarantee." *Id.* § 3.02(6). "A specific example of refusal to perform obligations under the guarantee is use of satisfaction or your money back' when the guarantor cannot or does not intend promptly to make full refund upon request." *Id.*

Although these regulations were promulgated for consumers' benefit, they may be invoked by businesspersons under § 11. *Public Works Supply Co. v. Stewart & Prince, Inc.*, 77 Mass. App. Ct. Adv. Sh. 870 (1977). This decision, coupled with the FTC's position regarding failure to honor refund promises made to franchisees, provides substantial support for § 11 plaintiffs who wish to invoke ch. 93A action against those who wrongfully disregard such refund promises.

97. See note 109 *infra*. See also text accompanying notes 107-130 *infra*.

and the Massachusetts Supreme Judicial Court. The fact patterns on which the FTC interpretations are based are common enough for such interpretations to be generally applicable to many commercial transactions even though expressly presented within the context of franchise or business venture offerings. Furthermore, recent Massachusetts decisions⁹⁸ independently embrace these FTC teachings.

a. *Material Matters for Disclosure*

In many business transactions, an offeror thinks he is acting lawfully when he fails to disclose something of importance so long as he does not expressly make a misrepresentation. This is not so. Under the FTC Rule, the doctrine of *caveat emptor* no longer applies. Simple silence may be unfair, deceptive or both if there is a nondisclosure of a fact which is material to an informed assessment of the risks and benefits of an offering. Because of the informational imbalance often found to exist between the offeror and offeree and the ease of exploiting offerees, there is an affirmative duty to disclose in good faith matters which the offeror knows or has reason to know would be material.⁹⁹

Price. In franchise offerings, there has been complaint that franchisors failed to disclose initial or recurrent fees which served to increase the price of that which was offered.¹⁰⁰ The FTC Rule, therefore, requires disclosure of fees to be paid to the offeror, its affiliates or third parties in which it has a financial interest, deposits on rent or equipment, and other payment obligations which must be satisfied to make a venture operative following a significant investment. This also applies to recurring fees such as royalties, rent, service charges, advertising contributions and the like. It would apply if the offeree was required to purchase supplies from the offeror or a third party at such high prices that operating the venture would prove unprofitable. If the price of the opportunity is

98. *Mechanics Nat'l Bank v. Killeen*, 79 Mass. Adv. Sh. 129, 384 N.E.2d 1231 (1979); *Heller v. Silverbranch Constr. Corp.*, 78 Mass. Adv. Sh. 2850, 382 N.E.2d 1065 (1978).

99. Even if liability is shown, substantial proof of good faith disclosure may certainly aid in one's avoiding double or treble damage liability under MASS. GEN. LAWS ANN. ch. 93A (West 1972). Section 11 provides that the court may, in its discretion, award such damages if the guilty party acted willfully or knowingly. *Id.* § 11 (West Cum. Supp. 1979). Section 9(3) grants similar relief where a commercial operator fails to resolve a consumer dispute in bad faith or with reason to know its actions violated the statute. *Id.* § 9(3) (West 1972).

100. 43 Fed. Reg. 59,633 (1978).

significantly affected by undisclosed matters,¹⁰¹ the offeree cannot make an informed investment decision.

The Offeror. Equally important is the data concerning the parties with whom the offeree is dealing.¹⁰² Historical background, financial condition, current standing in an industry, affiliations and reputation in the community, are all important especially in the case where the offeree's viability in an on-going business venture may directly depend on the stability and integrity of the offeror. The offeror should furnish current and truthful information about who it is, what it has done in the past and what it is currently doing. The same applies to its officers and key personnel.

Furthermore, it is material to know the offeror's recent financial history and its current condition. If the offeror has made similar opportunities available to others in the past and certain ventures have failed, such failures can be relevant to the offeree's decision.¹⁰³ In franchising, so long as no representations conflict with information set forth in the disclosure statement, an offeror may explain why factors which may have caused such failures are not present in the current offering.¹⁰⁴

Finally, it would be significant to know of past or pending litigation against the offeror or its key personnel or any bankruptcy or other insolvency proceeding in which the offeror was or may be involved. These matters must be disclosed initially because they reflect directly on the stability, integrity and reputation of the offeror.¹⁰⁵

Contractual Restrictions. In order to have a meeting of the minds with regard to all significant aspects of an arrangement, all matters should be presented clearly and simply. In particular, an offeree should fully understand what rights he may or may not have with regard to: termination of the relationship with the offeror, alienability of property rights which he has bargained for, in-term and post-term competition, use of confidential information

101. Compare MASS. GEN. LAWS ANN. ch. 140C (West 1974) with 15 U.S.C. §§ 1451-1461 (1976) (Truth-in-Lending Acts) which are nearly identical, embodying a comprehensive scheme of consumer credit information disclosure and which, in particular, set forth various items a credit offeror must disclose to an offeree because they constitute part of the price to be paid for a loan.

102. 43 Fed. Reg. 59,634 (1978).

103. With regard to franchise offerings, the Rule requires disclosure to prospective franchisees of the names and addresses of present franchisees most geographically relevant to the prospective offeree. 16 C.F.R. § 436.1(a)(16)(i)-(viii) (1979).

104. *Id.* § 436.1(a)(21).

105. *Id.* § 436.1(a)(4) & (5).

or trade secrets and conditions under which the arrangement may be modified. For example, if an on-going supplier-purchaser relationship is apparent in the venture and the offeror contractually exculpates itself from liability for negligence in the conduct of its business, this may or may not be satisfactory to the offeree. Even if it is acceptable, perhaps it should be reflected by a price reduction. The offeror is often more sophisticated and privy to more relevant information. This is especially true in cases in which the offeror prepares the written agreement delineating the rights and obligations of the parties. In order to deal fairly and in good faith, the offeror should affirmatively disclose¹⁰⁶ any contractual restrictions which it has reason to believe would be material to the offeree. Materiality here means the import which a contractual restriction may have on the risk to, or return on, the offeree's investment.

b. *Failure to Disclose Material Facts as an Unfair or Deceptive Act or Practice*

Minimally, the foregoing matters should be completely understood by both parties prior to consummation of the transaction.¹⁰⁷ A simple failure to disclose a material fact may be unfair, deceptive or both.

Unfairness. In the official statement of the basis and purpose, the FTC points to three unfairness criteria, emphasizing that a practice may be injurious to buyers of business offerings without regard to whether that practice is deceptive. These are the same criteria to which Massachusetts courts look in determining whether an act or practice is unfair, namely: (1) "Whether the practice . . . is within at least the penumbra of some common law, statutory or other established concept of unfairness; (2) [w]hether it is immoral, unethical, oppressive, or unscrupulous; or (3) [w]hether it causes substantial injury to consumers (or competitors or other businessmen)."¹⁰⁸ These criteria were originally applied by the FTC to

106. See U.C.C. § 2-316 which in certain instances requires conspicuous warranty disclaimers. Cf. *Badaracco v. Donahue Trailer Sales*, 7 MASS. LAW WEEKLY 482-83 (Dist. Ct. of Newton) (1979) (Chernoff, J.) (affirmative duty to disclose noncancellation clause on back of trailer sales agreement). See also 20 C.M.R. tit. 940, § 3.16 (1978).

107. The FTC Rule requires that a prospective franchisee have at least 10 days to review the franchisor's documents, particularly its disclosure statement, before a contract is signed or initial payment is made. 16 C.F.R. § 436.2(g) (1979).

108. 43 Fed. Reg. 59,635 (1978).

smoking advertisements directed toward consumers.¹⁰⁹ In 1972, the United States Supreme Court adumbrated the general application of these standards for "unfair" conduct¹¹⁰ while confirming that the judiciary should not substitute its judgment for that of the FTC. In 1975, the Massachusetts Supreme Judicial Court applied the same standards when a publisher refused to publish the plaintiff's advertisement.¹¹¹ The FTC has now reaffirmed their application to transactions involving sales of business opportunities to small businesspersons.¹¹²

Unfairness may be evaluated in terms of economic impact on consumers or businesspersons. But, in contrast to the competitive evaluation mandated by antitrust analysis under the Rule of Reason,¹¹³ the unfairness criteria require that other important public values be given considerable weight.¹¹⁴ According to the FTC: "All three (of the foregoing) criteria do *not* need to be satisfied to support a finding of unfairness. A practice may be unfair because of the degree to which it meets one of the criteria or because to a lesser extent, it meets all three."¹¹⁵ Therefore, to prove an unfairness claim, it is not always necessary to show that the conduct of which the private plaintiff complains "causes substantial injury to consumers (or competitors or other businessmen)."¹¹⁶ The failure

109. The unfairness criteria were originally set forth in the FTC's Statement of Basis and Purpose for Trade Regulation Rule 408, "Unfair and Deceptive Advertising and Labelling of Cigarettes in Relation to Health Hazards of Smoking," 29 Fed. Reg. 8,324, 8,355 (1964) and apparently approved in *FTC v. Sperry & Hutchinson*, 405 U.S. 233, 244 (1972), and *PMP Assocs., Inc. v. Globe Newspaper Co.*, 366 Mass. 593, 598-99, 321 N.E.2d 915, 917 (1975). They are: "1) whether the practice . . . is within at least the penumbra of some common law, statutory or other established concept of unfairness; 2) whether it is immoral, unethical, oppressive, or unscrupulous; or 3) whether it causes substantial injury to consumers (or competitors or other businessmen)." 43 Fed. Reg. 59,635 (1978).

110. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972).

111. *PMP Assocs. v. Globe Newspaper Co.*, 366 Mass. 593, 596, 321 N.E.2d 915, 917 (1975). *See also* 16 C.F.R. § 436.1(a)(21) (1979).

112. 43 Fed. Reg. 59,635 (1978).

113. *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679 (1978).

114. 43 Fed. Reg. 59,635 (1978).

115. *Id.* (emphasis added).

116. *Id.* *See* note 109 *supra*. There are cases which have required a showing of public impact in private suits brought under "little FTC Acts." *See, e.g.,* *Evanston Motors Co. v. Mid-S. Toyota Distrib.*, 436 F. Supp. 1370 (N.D. Ill. 1977) (conspiracy to supply cars to an area in an anticompetitive fashion). This case involved an alleged unfair method of competition as compared with an unfair practice. An unfair method of competition principally condemns antitrust violations and incipient antitrust violations while on unfair practice has a far greater sweep. Note also that there is no private right of action under the FTCA, and this fact has been used to buttress

to disclose a material fact may, therefore, constitute an unfair practice under the other unfairness criteria without any showing of public injury or impact.

As reflected in various federal and state laws,¹¹⁷ there is a recognized public policy encouraging affirmative disclosure to achieve informed consumer investment decisionmaking. Such policy is violated under circumstances in which: (1) A material fact about an offering exists; (2) there is a failure to disclose it; (3) the offeree is unable to discover or obtain such fact at a reasonable cost; and (4) the cost of requiring the offeror to furnish the information is not great compared to the economic harm which may be suffered by the offeree in making an uninformed purchase decision.¹¹⁸ In such cases, an unfairness claim may lie, depending on the circumstances of each case and the seriousness of the policy violation, as well as on the degree of injury or loss of money or property.¹¹⁹ The FTC has ruled that the failure of franchisors to disclose material facts about a franchise offering is an unfair act or practice in violation of section 5 of the FTCA. Such conduct, therefore, also violates chapter 93A.

Notwithstanding this FTC approach, Massachusetts appellate courts have commenced limiting the application of the unfairness prohibition in cases involving certain businesspersons.¹²⁰ When both parties appear to have substantial or relatively equal bargaining power, commercial experience, and financial prowess, a stronger showing of reprehensible conduct may be required.¹²¹ Under such circumstances, a plaintiff is more likely to be successful if he or she can show that the act or practice is immoral, unethical, oppressive or unscrupulous. "The objectionable conduct must at-

the so-called public impact prerequisite. However, the FTC supports the granting of a private right of action under FTCA § 5 to enforce its new franchise disclosure rule. 43 Fed. Reg. 59,723 (1978).

117. 43 Fed. Reg. 59,635-36 (1978). *Compare* the Federal Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976) (disclosure requirements of and policies supporting informed investment decision making) *with* the Truth-in-Lending laws. *Id.* §§ 1601-1667(e); MASS. GEN. LAWS ANN. ch. 140C, §§ 1-10 (West Cum. Supp. 1979).

118. 43 Fed. Reg. 59,635-36 (1978).

119. In October 1979, ch. 93A, § 9 was amended so that consumer plaintiffs need only show *injury* caused by the unlawful conduct. MASS. GEN. LAWS ANN. ch. 93A, § 9 (West Cum. Supp. 1979). Businesspersons suing under § 11 must still show loss of money or property. 1979 Mass. Acts ch. 406.

120. *Levings v. Forbes & Wallace, Inc.*, 79 Mass. App. Adv. Sh. 2043, 2050, 396 N.E.2d 149, 155 (1979).

121. *Id.*

tain a level of rascality that would raise an eyebrow of someone inured to the rough and tumble of the world of commerce."¹²²

This approach may well be sound in cases in which both parties are sufficiently inured to the rough and tumble world of cut-throat commercial competition. Such "unfettered competition"¹²³ is the primary mandate of the antitrust laws which are incorporated into chapter 93A under the rubric of "unfair methods of competition."¹²⁴ To accommodate that principle, the ban on unfair acts or practices was not primarily designed to protect those who could adequately fend for themselves in the marketplace. Instead, it was enacted to protect those who could not. According to the FTC, unsophisticated buyers of capital business offerings need and are entitled to receive greater protection than seasoned commercial manipulators.¹²⁵ In unfairness cases involving only experienced businessmen, perhaps a showing of "rascality" or particularly reprehensible conduct should be required, taking into consideration the reasonable expectations of hardened commercial participants. Such an approach, however, would be unsound if applied to the conduct of a seasoned commercial operator in dealings with an unsophisticated buyer of a franchise.

Taken together, recent Massachusetts and FTC interpretations vividly point out the flexibility of the unfairness prohibition. It is not subject to hard and fast rules. In most instances, the facts did dictate the conclusion even though an exact standard was lacking. Certain conduct may be unfair as to one plaintiff, but not necessarily as to another. An inflexible standard should not be applied, nor is one necessarily desirable. As with the duty to disclose, the duty to deal fairly varies from case to case depending on the capabilities and reasonable expectations of the parties. Until the courts have fleshed out the skeleton of the unfairness doctrine, each case will depend upon its own facts and must be decided on the basis of all the relevant circumstances.

Deception. Failure to disclose material facts may constitute a deceptive act or practice in violation of section 5 of the FTCA.¹²⁶

122. *Id.* Deceitful intent will successfully ground a claim under ch. 93A, § 11 *Levings v. Forbes & Wallace, Inc.*, 79 Mass. App. Adv. Sh. 2043, 2050, 396 N.E.2d 149, 155 (1979). *See Mechanics Nat'l Bank v. Killeen*, 79 Mass. Adv. Sh. 129, 384 N.E.2d 1231 (1979) (state of mind at the time of the commission of the act is relevant to an inquiry of unfairness).

123. *See* notes 10, 65 & 66 *supra*.

124. *Id.*

125. 43 Fed. Reg. 59,614, 59,624-27 (1978).

126. *Id.* at 59,636-37.

Because the deception analysis differs from the unfairness analysis, problems of proof in the latter case may be more difficult. An offeror's failure to disclose material information about an offering is deceptive if in the absence of disclosure, the offeree may reasonably believe a material fact to be significantly different from actuality.¹²⁷ If a venture is imbued with negative aspects which are as likely to occur as not, it would be deceptive for the offeror not to disclose this when offering the venture for investment. The same applies to the offer for sale of a product if affirmative disclosure is needed to avoid misleading the offeree as to important product attributes such as origin, composition and prior use.¹²⁸ In Massachusetts, the analysis is simpler. The statute is violated on deception grounds if there is failure to disclose any fact which *may* have influenced the buyer not to enter the transaction.¹²⁹ Of course, such failure also must have legally caused the injury or loss of money or property.¹³⁰

When an offered product or venture carries implied representations of function, status or affiliation which create corresponding assumptions in the offeree, it is deceptive not to disclose factual matters which would tend to rebut such assumptions.¹³¹ These bear directly on the risks associated with the venture, rather than the lack thereof implied by the failure to disclose. Because a failure to disclose such material facts may mislead an offeree as to the true risk or value of an offering, such failure constitutes a deceptive act or practice under section 5 of the FTCA.¹³²

V. APPLICABILITY OF THE RULE TO COMMERCIAL TRANSACTIONS EXCLUSIVE OF FRANCHISING

Since franchise offerings are similar to other commercial proposals, the FTC Rule and its accompanying interpretations may be

127. Query whether a reasonableness standard is appropriate. The duty to disclose should fluctuate inversely with the varying degree of sophistication of the perceiver of a representation. *Aronberg v. FTC*, 132 F.2d 165, 167 (7th Cir. 1942). See note 131 *infra*.

128. *Stolarczyk v. Doug Russell, Inc.*, No. 1013 (Mass. Super. Ct. 1977). A product claim may also be deceptive if it "fails to disclose facts necessary to dissipate false assumptions likely to arise in light of representations actually made." *FTC v. Simeon Management Corp.*, 532 F.2d 708, 716 (9th Cir. 1976).

129. 16 C.F.R. § 436.1(g) (1979); 20 C.M.R. tit. 940, § 3.05 (1978).

130. *Kohl v. Silver Lake Motors, Inc.*, 369 Mass. 795, 343 N.E.2d 375 (1976).

131. *Aronberg v. FTC*, 132 F.2d 165, 167 (7th Cir. 1942). It is safest for the commercial operator to act as though the consumer/entrepreneur with whom he is dealing falls within the ambit of the "ignorant, unthinking and the credulous." *Charles of the Ritz, Distribs. Corp. v. FTC*, 143 F.2d 676 (2d Cir. 1944).

132. *Charles of the Ritz Distribs. Corp. v. FTC*, 143 F.2d 676 (2d Cir. 1944).

legally applicable to such nonfranchise cases. Therefore, whether or not commercial activity involves franchising, the FTC Rule's teachings and its underlying policies can be used to assist business entities in achieving chapter 93A compliance.

Informational imbalance frequently exists between contracting parties. One party may be at a distinct negotiating disadvantage because of a lack of necessary information or access to the sources of such information. If this is accompanied by a financial disadvantage, the need for disclosure in conformity with the FTC Rule may come into play. Other sources of disparity can be based on the availability of expert advice, temporal factors, and empirical experience. Under those circumstances, it is immaterial whether the offering is for the sale of a fast food franchise, a piece of heavy or office equipment, a donut shop or a vehicle for business purposes. To avoid unfair or deceptive conduct, the seller should be able to provide substantiation for all claims and should make meaningful disclosure.

For every significant business investment, an equivalent risk of loss contingency can develop. This contingency gives rise to a need for information and protection similar to that required by the FTC Rule for the potential franchisee. The offeree should be given information on: the background of the persons with whom he or she is dealing; their experience in the particular commercial area involved; whether their history is satisfactory financially, commercially and litigiously; the initial or recurrent costs involved in the offering; whether any other items must be acquired for the offered item to work properly as contemplated and whether such items may only be obtained through particular sources; whether consideration is paid to the offeror by third parties as a result of the offeree's doing business with such parties; whether the offeror provides financing and, if so, its terms; whether there are contractual or other restrictions on the offeree's use of the item offered and, if so, what they are; and whether training in the use or operation of the item is necessary or available and, if so, at what cost.¹³³

All material information of this nature should be made available to an offeree so that a sound investment decision may be made. Even when sophisticated commercial entities of relatively equal bargaining power contemplate business with each other, such information also would be required for analysis prior to consummation of an important transaction. It should not matter whether the

133. 16 C.F.R. § 436.1 (1979).

offeror is selling franchises, business opportunities, services or property. Under circumstances in which one party is at a distinct financial and informational disadvantage, disclosure by the party with the advantage would materially reduce chapter 93A liability exposure. Marketing and operating policies can and should remain competitive and sound when one complies with this imperative.

A. *Sale of Tangible Property*

For maximum protection, material representations should be made in the manner set forth in the FTC Rule and its guidelines.¹³⁴ This can be illustrated where a "small" businessperson needs a computer or copy machine for use in his or her business. As with the purchase of a franchise, this businessperson needs substantial, detailed information to make a rational investment decision. For example, the offeror should be prepared to explain adequately the advantages and disadvantages of leasing and buying. While leasing may be more profitable for the seller, if there are reasons why a purchase may be more attractive to the buyer, these reasons should be disclosed. Normally, there should be disclosure of useful life, resale value, depreciability and other tax advantages, costs, energy efficiencies, and performance information.

Performance claims should be made with reasonable availability of substantiation and with sound bases in fact.¹³⁵ They bear on the ultimate value of an offering as it relates to the business profits which may be earned by the offeree. For this reason, the performance claim is typical of other important representations which may have to be made. As a matter of marketplace fairness, consumers must be able to rely on performance claims for meaningful comparison shopping. Usually, it would be prohibitively expensive to obtain independent business evaluation by an expert.

Making an affirmative product claim in advertising is deceptive and unfair to consumer entrepreneurs if there is no reasonable basis for it.¹³⁶ This rule should apply in business outside the context of franchising and advertising.¹³⁷ An economic gamble, which is created by the offeror's activity, is involved in relying on an offeror's affirmative product claim. There is relatively minimal cost to the offeror to have and make available such substantiation, as

134. *Id.* § 436, 44 Fed. Reg. 49,966 (1979); 43 Fed. Reg. 59,614 (1978).

135. 43 Fed. Reg. 59,632 (1973).

136. *In re . . . Pfizer Inc.*, 81 F.T.C. 23, 62 (1972).

137. *Id.* *Continental Wax Corp. v. FTC*, 330 F.2d 475 (2d Cir. 1964).

compared with the losses which would impact offerees in the absence of disclosure. Thus, economic fairness dictates that the substantiation and disclosure obligation be imposed on offerors. Earnings representations associated with property offerings are no different. The marketplace goals of fair dealing and competition would be well served if offerors satisfied these obligations in good faith and with due diligence.

The same rationale applies to failure to disclose material facts outside the franchising context. A product claim would be unfair and deceptive if misleading due to failure to disclose facts necessary to dissipate misleading assumptions.¹³⁸ For example, if it is reasonable to expect that a refund will be made under certain circumstances and in fact the opposite is true, such fact should not be omitted prior to acceptance of an offer. This also applies if delivery of a product will be unreasonably delayed or if delivery in the quantity or quality reasonably expected is not forthcoming.

B. *Sale of Services*

The FTC Rule and its teachings would seem to apply to the purchase of services¹³⁹ from a consulting, legal, accounting, credit investigation or similar organization. Representations should be based on fact and substantiation should be available. The analogy is particularly close since such service companies provide "know how" and methods of operation comparable to the offering made by franchisors to prospective franchisees. The exact nature and extent of the services to be provided should be fully explained and reduced to writing.

For example, if an attorney has been retained to represent a business client in business litigation, it is the attorney's duty to inform the client of his or her policies regarding a variety of matters including: The basis for payment, for example, hourly rate or contingent fee or by some other method; limitations on the client's ability to resolve the dispute without the attorney's consent; limitations on the work which the client may expect to be performed by the attorney, such as whether representation of the client on appeal is or is not included; the manner in which costs will be paid; and any credit terms that may be given.

138. 43 Fed. Reg. 59,636 (1978). See *Heller v. Silverbranch Const. Corp.*, 1978 Mass. Adv. Sh. 2850, 332 N.E.2d 1065, 1070; *accord*, *In re J.B. Williams Co.*, 68 F.T.C. 481, 485 (1965).

139. See *Nader v. Citron*, 372 Mass. 96, 360 N.E.2d 870 (1977).

Trial attorneys who are engaged for defense often render services on a time basis and are unable to estimate accurately the total amount of work to be done and its cost. When giving clients a "best estimate" of the time and costs involved, the client's understanding of the representations and the fact that there is no assurance as to the total fee should be carefully documented.

In addition to price related representations, the attorney should inform the client of facts concerning his or her background and experience, if it is material. Failure to disclose important facts, such as that the attorney had never previously conducted a trial or litigated a business dispute, could be actionable since such facts may have had the tendency to influence the prospective client not to enter into the attorney-client relationship.¹⁴⁰ Assuming disclosure of such facts, the price for the attorney's services would probably be adjusted accordingly or the client would not enter the transaction.

In Massachusetts as well as in the other states which have enacted "Little FTC Acts," regulation of unfairness and deception in the offering of commercial services is advancing rapidly. The attorney-client situation was posited as an example of the rendering of unfranchised commercial services in cases in which compliance with the FTC Rule's teachings would serve to lower exposure under chapter 93A. Similar benefits would accrue to those offering a variety of other commercial services.

This can be illustrated by certain Massachusetts decisions under chapter 93A in cases not involving franchising. For example, just as it has been found unlawful for franchisors to exact unfair contractual advantages and to misrepresent the nature of services or obligations to be performed, similar conduct has already been held unlawful in Massachusetts outside the context of franchising. In one case, it was held unfair to exact a contractual charge for the transfer of a mobile home space from one tenant to another when nothing of value was given in exchange.¹⁴¹ In another case, the court held that chapter 93A was violated for failure to disclose conspicuously a noncancellation clause in small print on the reverse side of a contract.¹⁴² In a third case,¹⁴³ it was held that chapter

140. 20 C.M.R. tit. 940, § 3.16 (1978); 16 C.F.R. § 436.1(g) (1979).

141. *Commonwealth v. Decotis*, 366 Mass. 234, 241, 316 N.E.2d 748, 755 (1974).

142. *Badaracco v. Donahue Trailer Sales*, 7 MASS. LAW WEEKLY 482-83 (Dist. Ct. of Newton, 1979) (Chernoff, J.).

143. *Dodd v. Commercial Union Assurance Co.*, 77 Mass. Adv. Sh. 1540, 365 N.E.2d 802 (1977).

93A applied to bad faith conduct rendered by an insurance company in failing to respond adequately to, investigate, service promptly or settle customer claims notwithstanding that a statute had been previously enacted to regulate unfairness and deception in the insurance industry.¹⁴⁴ If bad faith is shown, the conduct is conceptually no different from wrongfully failing to satisfy contractual obligations promised to franchisees to supply products, services or training timely and reasonably.

Additionally, claims of unfair competition, unfair methods of competition and antitrust violations fall within the prohibitions of both statutes.¹⁴⁵ Contractual restrictions extinguishing a franchisee's freedom to set prices have been held to violate the antitrust laws¹⁴⁶ and chapter 93A. The same is true for express requirements that "tied" products be purchased from the franchisor or its designee if the franchisee desires to purchase the "tying" product, for example, the franchise.¹⁴⁷ The applicability of these anticompetitive rules is not limited to franchising and is in fact broadly applicable to a variety of commercial situations. Similarly, commercial bribery¹⁴⁸ and payment of undisclosed kickbacks¹⁴⁹ to third parties, including franchisors, have been proscribed under section 5 of the FTCA.

The policies underlying the federal and Massachusetts statutes

144. *Id.* at 1547, 365 N.E.2d at 805; MASS. GEN. LAWS ANN. ch. 176D (West 1958). *But cf.* *Reiter Oldsmobile, Inc. v. General Motors Corp.*, 79 Mass. Adv. Sh. 2091, 2096, 393 N.E.2d 376, 377 (1979) (remedies given motor vehicle dealer or franchisee by ch. 93B are the only remedies available and preempt application of ch. 93A).

145. *FTC v. Texaco Inc.*, 393 U.S. 223 (1968); *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966); *FTC v. Cement Inst.*, 333 U.S. 683 (1948); *Adolph Coors Co. v. FTC*, 497 F.2d 1178 (10th Cir. 1975), *cert. denied*, 419 U.S. 1105 (1974); *Chicken Unltd. v. Bockover*, 873 ANTITRUST & TRADE REG. REP. (BNA) D-1 (Fla. Cir. Ct. 1978), *rev'd on other grounds*, 374 So. 2d 96 (Fla. Dist. Ct. App. 1979); *In re Howard Johnson Co.*, [1976-1979 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,577, at 21,685 (F.T.C. 1979); *In re Chock Full of Nuts Corp.*, 83 F.T.C. 575 (1973).

146. *See* note 145 *supra*. Compare the pricing claims brought under ch. 93A in *Massachusetts v. Leviton Mfg. Co.*, 868 ANTITRUST & TRADE REG. REP. (BNA) D-4 (D. Mass. 1978) with *In re Levi Strauss & Co.*, 901 ANTITRUST & TRADE REG. REP. (BNA) D-1 (Mass. Super. Ct. 1978).

147. *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966); *See* H. BROWN, *supra* note 57, at 281-368 (discusses protection afforded to franchisees by the federal antitrust laws). For a most recent and cogent discussion of tying violations under the antitrust laws examine *Photovest Corp. v. Fotomat Corp.*, [1979] 2 TRADE CAS. (CCH) ¶ 62,869, at 79,019 (7th Cir. 1979).

148. *American Distilling Co. v. Wisconsin Liquor Co.*, 104 F.2d 582 (7th Cir. 1939).

149. *In re Barton's Candy Corp.*, 79 F.T.C. 101, 103-04 (1971). *See* *Virginia v. Padgett*, 930 ANTITRUST & TRADE REG. REP. (BNA) D-13 & 14 (Va. Cir. Ct. 1979); 16 C.F.R. §§ 436.1(11), .2(i) (1979). *See also* 43 Fed. Reg. 59,657-59 (1978).

are nearly identical. Parallel enforcement of these statutes by the public and private sectors is proceeding purposefully. With respect to consumers and businesspersons, and in franchising as well as other commercial arenas, there are fundamental public policies to encourage fair dealing and informed business decisionmaking. Strong support for these policies is evident from chapter 93A's generous provisions for multiple damages, costs (including experts' fees),¹⁵⁰ and attorneys' fees, both to encourage private enforcement and to deter violators. Informed consumers and businesspersons are essential to the fair and efficient functioning of a free market economy.¹⁵¹ Massachusetts courts have been strengthening such policies by following the legislative mandate to give FTC interpretations due respect in interpreting section 2(a) of chapter 93A.¹⁵²

VI. COMPLIANCE SUGGESTIONS

The foregoing FTC formulations of the unfairness and deception doctrines can provide meaningful guidance for commercial operators. Financial exposure under chapter 93A can be quite substantial. Persons engaged in commerce should strongly consider adjusting business practices in order to achieve compliance. Many varieties of practices can be carefully developed and implemented to assist in avoiding liability and in minimizing damages. The ensuing good will among consumers and other businesspersons should be of substantial benefit.

The cost and benefit of such development and implementation must be weighed against the ever present spectre of multiple damages, attorneys' fees and class suits under chapter 93A. Moreover, because there is no adequate predefinition of what is or is not unfair, these risks are increased. If a businessperson evaluates a business practice incorrectly and that practice is later determined to be unfair or deceptive, such person will have acted contrary to public policy, often with no intention of doing so. Furthermore, if such person's business involved franchising, that unfairness determination would now have to be disclosed to any potential franchisee

150. MASS. GEN. LAWS ANN. ch. 93A, §§ 9, 11 (West 1972). See *Linthicum v. Archambault*, 79 Mass. Adv. Sh. 2661, 398 N.E.2d 482 (1979).

151. 43 Fed. Reg. 59,635 n.95 (1978) (citing MacIntyre & Von Brand, *Unfair Methods of Competition as an Evolving Concept-Prelude to Consumerism*, 44 ST. JOHN'S L. REV. 597 (1970)).

152. For a brief summary of unfair and deceptive practices as well as a recent summary of substantive and procedural rules under ch. 93A see PREPARATION AND TRIAL OF A CH. 93A CASE (1979) (published for seminars presented by the Massachusetts Academy of Trial Attorneys).

pursuant to the FTC Rule. The repercussions from such disclosure could be disastrous and should be avoided.

Historically, businesspersons have often relied on the direct profit factor, the lack of probable detection, the cost of litigation, legal technicalities and similar defensive factors.¹⁵³ But in real economic terms, both society and the individual businessperson should fare better when transactions and methods of dealing are fair, honest and reasonable. Such a value judgment finds support in the increasing formulation of policies and standards for commercial conduct embodied in laws, such as the "Little FTC Acts" and the FTC Rule. The old adage of "buyer beware" has been completely changed. Now it is the seller who must be very careful. The following suggestions are, therefore, offered to aid businesspersons in complying with these laws in the sale of business opportunities and in other comparably important commercial transactions.

The seller should carefully measure the levels of perception and sophistication of the potential buyer. Duties to deal fairly and to disclose fully necessarily fluctuate with the capacity of each offeree. A good rule of thumb for determining the capacity of a representation to deceive, is to estimate the impression a representation is likely to have on the general populace.¹⁵⁴ A higher duty would be in order when a representation or practice is directed at an especially susceptible or unsophisticated audience. Further, the setting in which an offer is made should not be prone to abusive or exploitative marketing practices. Marketing texts and other business materials can be consulted to determine the most suitable atmosphere.

The seller should provide a prospective offeree with all information needed to make an informed investment decision, including disclosure of the applicable categories of information required by the FTC Rule. The seller should also comply with the disclosure standards of the Attorney General's regulations.¹⁵⁵ The information may include opinions of accountants, attorneys, and in particular, those of other consumer entrepreneurs who had been offered and who accepted the venture. If available, both good and bad opinions should be presented. To rectify the informational imbalance, the seller should implement a system to assure that all pertinent and

153. 43 Fed. Reg. 59,622-27 (1978).

154. *Feil v. FTC*, 285 F.2d 879, 892 (9th Cir. 1960). See also notes 26 & 71 *supra*.

155. See notes 17 & 75 *supra*.

truthful information which could have been provided was in fact provided. This might be buttressed through the use of signed receipts and authorized tape recordings.

Sellers should avoid exploitative marketing practices which emphasize playing on the instant success mentality. They should not use alluring phrases and come-ons such as "be your own boss" and "this is a lifetime opportunity." Any such emphasis should be strongly penalized, especially where the offeree is unsophisticated. A company should warn its salespeople, particularly when commission sales are involved. It is often necessary to police sales personnel, since the desire to make a sale and earn a commission can overcome the will to maintain honesty and openness.

Sellers can also screen out the ignorant, naive, inexperienced and overall losers who would be unlikely to handle the transaction successfully. These are the individuals who are most likely to come back with outrageous demands to resolve their problems. Depending on the sophistication level of proposed buyers, the seller should adopt sufficient methods and standards commensurate with the difficulty of succeeding in the venture and the statistical likelihood of success. Educational or vocational requirements may be important tools to achieve such goals.

Sellers would do well to require that the offeree be represented and given an opinion by competent experts. If analysis of financial statements is involved, the opinion of a licensed or certified public accountant should be required for the offeree's benefit. It may be advisable to suggest the need for a business consultant or retail marketing analyst. The seller should offer clear and understandable terms, with a recommendation to obtain competent legal advice. Realistically, such a program must assume that the seller has formulated a worthwhile venture that can sustain such scrutiny. The best way to avoid the risks presented by chapter 93A is to devise sound products or service offerings and to administer them properly.

Procedures can be very important. For example, the seller should use and honor simple, understandable forms, manuals, and covenants. The buyer should be given as much "decision" time as would reasonably be necessary to understand and decide upon a transaction, including sufficient time for his advisors to review the transaction. The seller should avoid all forms of excessive pressure, particularly in the temporal sense.

If the seller proposes refund and additional or alternative warranty policies, they should be clearly represented and then implemented in good faith both as to procedure and substance. A gener-

ous refund factor could well be considered as another cost of doing business. At the least, this would enable the seller to tender substantial repayment as a means of avoiding exemplary damages and attorneys' fees. Moreover, if the offeror has done a good job of devising the product or service offered, repurchase should not present a problem. If the product is a good one, then presumably it could be resold at a moderate discount in the normal course of business. If major deficiencies exist, the prospective buyer may have had little or no opportunity to obtain the benefit of the bargain.

Commercial operators who enter into potentially long-term relationships with prospective entrepreneurs can do a great deal to establish a solid, financially rewarding business relationship from which all can derive benefit. Compliance with these suggestions and the policies underlying the statute should help to achieve such results. If and when the seller must defend itself, it will be invaluable to rely on a business system designed with fairness than to defend one designed on barely satisfying contractual or statutory technicalities. Both under chapter 93A and before a parochially oriented jury, provable justification may provide the only meaningful defense.

No matter how fair, honest or reasonable the commercial operator may have been, some offerees will not succeed in their ventures. Whether it is their fault or that of the commercial operator, some entrepreneurs will seek restitution from the major company. Such behavior must be anticipated. The cost of dealing with such disputes should be contemplated and projected. A substantial reserve should be set aside to process and resolve these disputes on a short term basis. As a practical matter, it is often too expensive and too risky to defend these claims unless there is an exceptional record of full disclosure and solid substantiation. If the claim seems bona fide, chapter 93A encourages settlement.¹⁵⁶ The overreaching plaintiff who rejects an offer of settlement in the range of single damages will find no sympathy in the courts and will lose the claim for exemplary damages.¹⁵⁷

VII. CONCLUSION

The FTC Rule is an important legal formulation of law and policy in the area of commercial unfairness and deception. At least

156. MASS. GEN. LAWS ANN. ch. 93A, §§ 9, 11 (West 1972).

157. MASS. GEN. LAWS ANN. ch. 93A, § 9 (West 1972); *Kohl v. Silver Lake Motors, Inc.*, 369 Mass. 795, 343 N.E.2d 375 (1976).

in the franchising context, the history of abuses showed evidence of the need for full disclosure. Disclosure will reduce the severity and frequency of consumer injury resulting from unlawful business opportunity offerings. More protection is necessary to cover the ongoing relationship between the well financed, sophisticated, commercial operator as against the small businessperson in order to effectuate the policies of good faith and fair dealing. Private enforcement of economic regulatory statutes like chapter 93A is the primary approach available to consumer entrepreneurs to assure such good faith and fair dealing throughout the duration of business relationships.

In addition to exploring the context and meaning of the FTC Rule, an effort has been made to show its substantial impact on Massachusetts law. The substantive scope of the FTC Rule is vast and detailed, providing persuasive authority for broad application. Students and users of the statute have been provided with valuable interpretations for relatively common business transactions. They also have been provided with a guide for understanding the differences between the unfairness and deception analyses which heretofore had been overlooked. Separate evaluation of the unfairness and deception doctrines can aid in the precise formulation of claims and defenses. Accordingly, there will be more efficient judicial resolution of business disputes.

Additionally, suggestions have been offered to aid commercial operators in complying with the FTC Rule. These suggestions are not intended to be exhaustive. Furthermore, both the FTC interpretations and suggestions for compliance should not be viewed as applicable only to offerings of business opportunities and similar relationships. The rules regarding deception and unfairness are designed to be flexible to apply to the never ending variety of business transactions and relationships which may be contemplated by those with entrepreneurial creativity.

There may be some justifiable complaint over the heavy burdens and expense required for compliance. But failure to meet that challenge can result in devastating exposure to exemplary damages. Further, the cost of compliance can be spread over an entire business operation and passed on to the ultimate purchasers. Those subject to chapter 93A are best able fairly to bear the cost of compliance. In any event, they have a legal obligation to comply. In all probability, those who comply will benefit from the long-term development of the good will of their customers.